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IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS LLC,
Petitioners,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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BRIEF FOR PROFESSORS JAMES D. COX, JILL E. FISCH, DONALD C. LANGEVOORT, RICHARD M. BUXBAUM, MELVIN A. EISENBERG AND HILLARY A. SALE AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether a person who actively engages in a sham transaction with the purpose and effect of causing a publicly traded company to make a materially false or misleading statement of its financial condition has used or employed a deceptive device or contrivance within the meaning of §10(b) and has thereby committed a primary violation of the statute.

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INTEREST OF *AMICI CURIAE* [1]

Amici are law professors who study, analyze and teach the federal securities laws and their role in regulating U.S. capital

[1] Counsel for respondents and for petitioners have consented to the filing of this amicus brief. This brief was not authored, in whole or in part, by counsel for either party. Sanford Svetcov and Susan Alexander of the Lerach Coughlin firm—other members of which are counsel of record for The Regents of the University of California ("The Regents"), petitioners in *Regents v. Merrill Lynch*, No. 06-1341, presenting the same issue as is raised here, and counsel for The Regents in submitting a separate *amicus* in this case—have provided substantial assistance in the preparation and submission of this *amicus* brief. The Lerach Coughlin firm paid for the printing of the brief.

markets. A brief summary of their individual and collective experience follows:

1. Professor James D. Cox joined the faculty of the School of Law at Duke University in 1979 where he specializes in corporate and securities law. Previously, he taught at the law schools of Boston University, the University of San Francisco, Stanford University and at Hastings College of the Law. Professor Cox earned his law degree at the University of California, Hastings College of the Law (J.D.) and Harvard Law School (LL. M.). In addition to his texts *Financial Information, Accounting and the Law*; *Cox and Hazen on Corporations*; and *Securities Regulations Cases and Materials* (with Professors Hillman & Langevoort), Professor Cox has published extensively in the areas of market regulation and corporate governance as well as having testified before the U.S. House and Senate on insider trading and market reform issues. He is a former member of the New York Stock Exchange ("NYSE") Legal Advisory Committee and a member of the National Association of Securities Dealers ("NASD") Legal Advisory Board.

2. Professor Jill E. Fisch is a Visiting Professor at the University of Pennsylvania Law School and T.J. Maloney Professor of Business Law at Fordham University. In 1989, after obtaining her J.D. from Yale Law School, and two years with the Justice Department and the Cleary Gottlieb firm, respectively, Professor Fisch joined the Fordham faculty where she serves as Director of the Fordham Corporate Law Center. Professor Fisch teaches corporations, securities regulation and federal courts. She is chair-elect of the Section on Securities Regulation and a former chair of the Section on Business Associations of the Association of American Law Schools. Professor Fisch's scholarship includes work on corporate law, securities regulation, and federal courts, that have appeared in a variety of publications including the Harvard, Columbia and Cornell Law Reviews, and the Yale

Law Journal. (*E.g.*, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 Colum. L. Rev. 650 (2002).

3. Professor Donald C. Langevoort is Thomas Aquinas Reynolds Professor of Law at Georgetown Law Center. He received a J.D. from Harvard. Prior to joining the Law Center faculty in 1999, Professor Langevoort was the Lee S. and Charles A. Speir Professor at Vanderbilt University School of Law, where he joined the faculty in 1981. After practicing for two years at Wilmer, Cutler & Pickering in Washington, D.C., he joined the staff of the U.S. Securities & Exchange Commission ("SEC") as Special Counsel in the Office of the General Counsel. Professor Langevoort is the co-author, with Professors James Cox and Robert Hillman, of *Securities Regulation: Cases and Materials*, and the author of a treatise entitled *Insider Trading: Regulation, Enforcement and Prevention.* Professor Langevoort has testified numerous times before Congressional committees on issues relating to insider trading and securities litigation reform.

4. Professor Richard M. Buxbaum received his law degrees from Cornell Law School (LL.B. 1952) and the University of California, Boalt Hall School of Law (LL.M. 1953). After practicing law for eight years, he joined the Boalt faculty in 1961. He publishes and teaches in the fields of corporate law and comparative and international economic law. Professor Buxbaum has served on various state and national committees engaged in the drafting of securities legislation.

5. Melvin A. Eisenberg is Koret Professor of Law at the University of California, Boalt Hall School of Law. He received his law degree from Harvard in 1959. After practicing with the Kaye Scholer firm in New York, and serving as assistant counsel to the Warren Commission, he joined the Boalt Faculty in 1966. Professor Eisenberg is the author of *The Structure of the Corporation* (1997) and has

published casebooks on the subjects of contracts and corporations. He was chief reporter for the American Law Institute's *Principles of Corporate Governance*.

6. Professor Hillary A. Sale holds the F. Arnold Daum Chair in Corporate Finance and Law at the University of Iowa College of Law, where she joined the faculty in 1997. She is the author of numerous articles on securities and corporate governance issues. Two of her articles, *Delaware's Good Faith* (2004) and *Securities Fraud as Corporate Governance: Reflections Upon Federalism* (2003), were selected by the *Corporate Practice Commentator* as among the "top ten" corporate and securities law articles published in those years. She is co-author of the *Securities Regulation* casebook with John Coffee and Joel Seligman, and is a member of the ABA Committee on Corporate Laws.

The issue in this case is whether a person is liable under §10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)) and SEC Rule 10b-5 (17 C.F.R. §240.10b-5) for actively engaging in sham transactions with the purpose and effect of causing a public company to misrepresent its financial condition, even though the person himself makes no public misstatement. Here, the Eighth Circuit held that absent "a fraudulent misstatement or omission," a person's deceptive acts as part of a scheme to defraud are no more than aiding and abetting for which no private civil liability exists under §10(b) in light of this Court's decision in *Central Bank N.A. v. First Interstate Bank N.A.*, 511 U.S. 164 (1994). *In re Charter Commc'ns. Sec. Litig.*, 443 F.3d 987, 992 (8th Cir. 2006).

Amici, who have for many years studied the effect of the federal securities laws on capital markets, are concerned that such a narrow construction of §10(b) could seriously impair the integrity of our securities markets by precluding investor recovery from those responsible for devastating losses caused by fraudulent schemes with multiple actors, only one of whom

makes a public misrepresentation. The Court of Appeals' grudging construction is flatly inconsistent with the plain language of §10(b) and Rule 10b-5, and with *Central Bank* itself. Indeed, *Central Bank* cabins its holding to knowing assistance through lawful conduct, but reaffirms §10(b) liability for "deceptive" as well as "manipulative" acts. 511 U.S. at 178, 191.

As discussed in this brief, *amici* agree that actively engaging in a deceptive scheme of sham transactions requires far more than simply proceeding with a legitimate deal knowing it will assist, *i.e.* aid and abet, others who misrepresent the deal. But when there is far more, as in this case, then unless investors can recover from any person who engages in deceptive sham schemes, the integrity of our markets will suffer. These investors—and the markets—will suffer because centrally and recurrently involved third party schemers will face far weaker disincentives to avoid participating in sham transactions which they know are at the heart of a company's fraudulent misstatements. In some cases, where the company making misstatements is insolvent, such active schemers will be the only source of recovery.

SUMMARY OF ARGUMENT

Section 10(b) makes it "unlawful for any person" to "directly or indirectly" "use or employ" a "deceptive device or contrivance" to cause economic loss "in connection with the purchase or sale of any security." 15 U.S.C. §78j(b). Thus, according to its plain language, §10(b) proscribes deceptive ***conduct*** that purposefully causes a misrepresentation by a public company in connection with the purchase or sale of a security.

For nearly 40 years, this Court has recognized "beyond peradventure" the existence of an implied private right of action for damages for violation of §10(b). *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983). In enact-

ing the Private Securities Litigation Reform Act ("PSLRA") in 1995, with all of its procedural and substantive standards for private suits, Congress effectively made the private right of action explicit: "The provisions of this subsection shall apply in each private action arising under this title that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure." 15 U.S.C. §78u-4(a)(1).

In *Central Bank*, however, this Court barred private suits for aiding and abetting a §10(b) violation. 511 U.S. at 177. *Central Bank* rejected a substantial body of circuit law that had allowed private aiding and abetting actions under §10(b). *Id.* The circuits had long defined aiding and abetting to mean any conduct that knowingly assisted or facilitated another's fraudulent misrepresentations. *Id.* at 170-71. *Central Bank* rejected aiding and abetting liability under §10(b) because it exposed secondary actors to liability based simply on their participation in legitimate transactions, combined with reckless knowledge that a company would misrepresent or misreport those transactions. *Id.* at 168. This Court concluded that such knowledge was insufficient to turn a party engaging in a legitimate deal into a primary violator. *Id.* at 190.

Amici submit that actively engaging (unlawfully) in sham transactions and other deceptive conduct with the purpose and effect of causing misrepresentations involves far more than knowingly assisting through lawful conduct that *Central Bank* released from the reach of §10(b). Actively engaging in sham transactions is deceptive conduct designed to cause a company to make misrepresentations, and is distinct from ordinarily lawful acts of omission or commission that merely aid or assist another's misstatements. Thus, both the deceptive sham transaction and the subsequent misstatement constitute "unlawful" primary violations of §10(b).

Indeed, *Central Bank* itself reaffirmed primary liability for "persons who engage, ***even indirectly***, in a proscribed

activity." 511 U.S. at 176.[2] This Court made clear that in barring aiding and abetting liability it did not redefine "use" of a "deceptive device or contrivance." Rather, *Central Bank* affirmed ***primary*** liability for "***acts*** that are . . . themselves manipulative ***or deceptive*** within the meaning of statute." *Id.*

In so holding, this Court was consistent with its earlier decisions affirming liability for deceptive ***conduct***, as well as for statements and omissions. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-53 (1972). In *Huddleston*, for example, this Court held that an action under §10(b) "extends to 'any person' who engages in fraud in connection with a purchase or sale of securities" even though they did not themselves make the public misrepresentations contained in the company's registration statement that were separately actionable under §11. 459 U.S. at 387 n.22.

Shortly after *Central Bank*, Congress enacted the PSLRA and defined a knowing "'violation of the securities laws'" to include, in addition to misrepresentations, any conduct that is not a material misstatement or omission. 15 U.S.C. §78u-4(f)(10)(A). Thereafter, this Court emphatically stated that §10(b) does not require a "misrepresentation" by the defendant. *SEC v. Zandford*, 535 U.S. 813, 820 (2002). Recently, in *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 346 (2005), this Court again held that to prove a §10(b) violation, plaintiff must link its loss to "defendant's misrepresentation (***or other fraudulent conduct***)."

The deceptive conduct here is even more egregious than *Zandford*, where only a single investor was harmed, because here respondents conduct was designed and essential to enable direct misstatements by Charter that injured the entire market. Charter is liable under §10(b) for the misstatements. But, respondents who actively engaged in a scheme of de-

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[2] Emphasis is added, and internal citations and footnotes are omitted unless otherwise noted.

ceptive conduct, creating sham paper transactions causing Charter's public misrepresentations, should also be held accountable as primary violators of §10(b).

By implication, the Eighth Circuit appeared to acknowledge that sham transactions designed to cause deceptive statements may be actionable when it observed that §10(b) does not impose liability on a party that "entered into an arm's length non-securities transaction" with another party that uses the transaction to publish false statements. *Charter*, 443 F.3d at 992-93. The Eighth Circuit nevertheless proceeded to err in two discrete ways.

First, it recited but did not credit the allegations in the complaint that the transactions were sham, illegitimate "round-trip" deals with no value other than to falsely inflate Charter's publicly reported revenues: "Plaintiffs alleged that the Vendors entered into these sham transactions knowing that Charter intended to account for them improperly. . . ." *Id.* at 990. The Eighth Circuit overlooked that plaintiffs' complaint alleged that the vendors agreed to unlawful kickbacks and phony advertising fees that were complete shams. (Second Amended Consolidated Class Action Complaint, ¶¶7-11, 91-114). As this Court very recently reaffirmed, "'Rule 12(b)(6) does not countenance . . . dismissals based on a judge's disbelief of a complaint's factual allegations.'" *Bell Atlantic v. Twombley*, __ U.S. __, No. 05-1126, 2007 U.S. LEXIS 5901, at *22 (U.S. May 21, 2007) (quoting *Neitzke v. Williams*, 490 U.S. 319, 327 (1989)).

Second, the Eighth Circuit threw out the baby with the bath water. Ignoring its own apparent distinction between ***arm's length*** and ***sham*** transactions, it held that a §10(b) violation included only a misrepresentation (or omission with a duty to disclose) or a manipulative act (direct manipulation of stock trading). *Charter*, 443 F.3d at 992. The Eighth Circuit's narrow definition of "deceptive" limits it to the "making" of a misrepresentation, and thereby erroneously eliminates en-

tirely any ***conduct*** constituting the use or employment of a "deceptive device or contrivance" even though that language plainly reaches activities that cause a purposeful misrepresentation. The Eighth Circuit's narrow construction of the statute was error under *Affiliated Ute* and *Zandford*, and indeed under a proper reading of *Central Bank*.

ARGUMENT

I. *Central Bank* Bars Aiding and Abetting Liability, but Reaffirms Primary Liability for Actively Engaging in Deceptive Conduct that Causes a Public Company to Misrepresent Its Financial Condition to the Market

Central Bank did not reach—and does not limit—liability of actors who engage in deceptive conduct with the purpose and effect of creating a false appearance of fact regarding the true financial condition of a publicly-traded company. *Central Bank* expressly limited its consideration to those who aid and abet fraud, rather than those who actively engage in it.

The Court itself circumscribed the issue it addressed: "whether private civil liability under §10(b) extends as well to those who ***do not engage*** in the manipulative or deceptive practice." *Central Bank*, 511 U.S. at 167. Indeed, the allegation against Central Bank was based on a failure to act, rather than on any active conduct. *Id.* at 168 ("Central Bank agreed to delay independent review of the appraisal until the end of the year," by which time the public building authority had already defaulted). The Court reported that "Respondents concede that Central Bank did not commit a manipulative or deceptive act within the meaning of §10(b)." *Id.* at 191.

Central Bank explicitly distinguished between actors who do engage—even indirectly—in deceptive conduct and actors who merely aid and abet others. "[A]iding and abetting liability extends beyond ***persons who engage, even indirectly, in a proscribed activity***; aiding and abetting liability

reaches persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do." *Id.* at 176. That distinction is supported by the plain language of §10(b), this Court's subsequent decision in *Zandford*, and the PSLRA.

A. The Plain Language of Section 10(b) Prohibits Indirect As Well As Direct "Use" of a "Deceptive Device or Contrivance"—and Thus Proscribes Sham Transactions that Cause Misrepresentations by a Company in Connection with the Purchase or Sale of a Security

The statutory language is "'[t]he starting point in every case involving construction of a statute. . . .'" *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)). Putting the pertinent language of §10(b) side-by-side with the holding of *Charter* shows that the Eighth Circuit rewrote the plain meaning of the statute as follows:

It shall be unlawful for any person, ***directly or indirectly***, ...	It shall be unlawful for any person, ***directly*** [***but not indirectly***], ...
(b) To ***use or employ***, in connection with the purchase or sale of any security . . . ***any*** manipulative or ***deceptive device or contrivance*** in contravention of such rules and regulations as the [SEC] may prescribe	(b) To ***make or fail to make by one who has a duty to disclose*** [***but not use or employ***], in connection with the purchase or sale of any security . . . ***any manipulative device or contrivance or a deceptive statement*** [***but not any other deceptive device or contrivance***] in contravention of such rules and regulations as the [SEC] may prescribe . . . .

15 U.S.C. §78j(b), *cf*, *Charter*, 443 F.3d at 992 (holding "A device or contrivance is not 'deceptive,' within the meaning of §10(b), absent some misstatement or a failure to disclose by one who has a duty to disclose."). The Eighth Circuit's revisionist construction ignores the statute's plain language, its "commonly accepted meaning," and this Court's reliance on the dictionary to find that the common meaning of "device" and "contrivance" include "a scheme to deceive." *See Hochfelder*, 425 U.S. at 198-99 & n.20.

This Court previously rejected nearly identical logic from the Eighth Circuit in *United States v. O'Hagan*, 521 U.S. 642 (1997). Referencing the sentence from *Central Bank* in which the Court gave a shorthand definition of deceptive conduct which could be construed as limiting such conduct to misstatements or omissions (511 U.S. at 177), this Court clarified that no such limitation was intended:

> The Eighth Circuit isolated the statement just quoted and drew from it the conclusion that §10(b) covers only deceptive statements or omissions on which purchasers and sellers, and perhaps other market participants, rely. It is evident from the question presented in *Central Bank*, however, that this Court, in the quoted passage, sought only to clarify that secondary actors, although not subject to aiding and abetting liability, remain subject to primary liability under §10(b) and Rule 10b-5 for ***certain conduct***.

O'Hagan, 521 U.S. at 664.

Without revision, the plain text of the statute makes it "unlawful for any person, . . . indirectly, . . . to use or employ, . . . any . . . deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. §78j(b). As this Court held in *Central Bank*, "the statutory text controls the definition of conduct covered by §10(b)." 511 U.S. at 175. The Eighth Circuit's requirements of statements, omissions and duties simply do not appear in

the text. The plain meaning of the words "any . . . deceptive device or contrivance" necessarily includes conduct.

Following the plain text of the statute, the SEC's long-standing recognition of scheme and conduct liability in Rule 10b-5(a) and (c) is entitled to deference. *Int'l Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 566 n.20 (1979). Rule 10b-5 makes it unlawful for "any person, directly or indirectly," "(a) [t]o employ any device, scheme or artifice to defraud" and "(c) [t]o engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. §240.10b-5(a) and (c).

Prior to *Central Bank*, this Court had expressly stated that a defendant violates Rule 10b-5 when it engages in "a 'course of business' or a 'device, scheme, or artifice' that operates as a fraud." *Affiliated Ute*, 406 U.S. at 153. Nothing in *Central Bank* changes that. Indeed, continuing to follow the plain language of the statute, this Court recently held that to prove a violation, plaintiff must "prove that the defendant's misrepresentation (***or other fraudulent conduct***) proximately caused the plaintiff's economic loss." *Dura*, 544 U.S. at 346.

B. This Court's Decision in *Zandford*—Eight Years After *Central Bank*—Affirms Liability for Deceptive *Conduct*, as Well as for Statements and Omissions

In *Zandford*, this Court affirmed that commission of a deceptive act—even one not accompanied by a public misrepresentation—is subject to primary liability under §10(b). *Zandford*, 535 U.S. at 820. Eight years after *Central Bank*, this Court held that "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." *Id.* As noted above, the *Charter* case is stronger than *Zandford* because here respondents' deceptive conduct consisted of sham transactions that purposefully caused a public company

to directly misrepresent its financial results and thereby deceive market investors.

Beyond clarifying that deceptive conduct is not limited to statements or omissions, however, the Court's analysis in *Zandford* explains that where the "aggregate" impact of an actors' conduct operates "as a fraud or deceit," those facts support a finding that such conduct is "deceptive" and a basis for primary liability under the Act. 535 U.S. at 820-21. Where fraudulent purpose cannot be separated from the acts themselves, primary liability is appropriate: "The securities sales and respondent's fraudulent practices were not independent events. . . . Rather, respondent's fraud coincided with the sales themselves." *Id.* at 820. Thus, where a sham transaction has the purpose and effect of operating as a fraud or deceit on the market in connection with trading in securities by causing the misrepresentation of the true financial condition of a publicly-traded company, the principals to that transaction have committed "deceptive conduct," actionable as a primary violation of §10(b).

The SEC defines "a deceptive act" similarly: as "'engaging in a transaction whose principal purpose and effect is to create a false appearance of revenues.'" *See Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006). In *Zandford*, this Court held that "[The SEC's] interpretation of the ambiguous text of §10(b), in the context of formal adjudication, is entitled to deference if it is reasonable." *Zandford*, 535 U.S. at 819-20.

As the Ninth Circuit explained, the analysis of whether primary liability lies under §10(b) properly focuses on the defendants' own conduct: "the defendant's ***own conduct*** contributing to the transaction or overall scheme must have had a deceptive purpose and effect." *Simpson*, 452 F.3d at 1048 (emphasis by the court). "The focus of the inquiry on the deceptive nature of the defendant's own conduct ensures that only primary violators (that is, only those defendants who use

or employ a manipulative or deceptive device) are held liable under the Act." *Id.* at 1049. "If multiple participants used or employed a deceptive device in furtherance of a scheme to misrepresent the reported revenues of a company, then all participants may be viewed as having acted in connection with the purchase or sale of securities." *Id.* at 1051. The requirement of reliance on the integrity of the market price is satisfied because a misleading public statement is the intended end result of the scheme. *Id.* at 1052.

Focus on a defendant's own conduct is consistent with this Court's direction in *Zandford*, holding that §10(b) "should be 'construed . . . to effectuate its remedial purposes'" (535 U.S. at 819), and in *Central Bank*, holding that what §10(b) "'catches must be fraud.'" 511 U.S. at 174. Thus, a defendant whose own conduct has the purpose and effect of creating deception in connection with the purchase or sale of a security is properly subject to primary liability under §10(b)—whether his own conduct involved a misstatement, an omission, or some other device or contrivance that causes a misrepresentation.[3]

C. The PSLRA—One Year After *Central Bank*—Affirms Congress' Continuing Intention to Prohibit Deceptive *Conduct*

Congress demonstrated its intention to continue to prohibit deceptive conduct as well as deceptive statements and omissions in passing the PSLRA, Pub. L. 104-67, 109 Stat.

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[3] A recent district court decision highlights the risks of such an unduly narrow construction of §10(b). The court held that the principal asset manager of a group of mutual funds whose deceptive conduct was integral to a fraudulent scheme and who even disseminated the fund prospectus containing misstatements was not liable under §10(b) simply because the manager did not make the misstatements to the public that were the product of the scheme. *In re Mut. Funds Inv. Litig.*, __ F. Supp. 2d __, No. JFM-04-818, 2007 U.S. Dist. LEXIS 37923, at *5-*11 (D.Md. May 21, 2007).

737 (1995). In addressing proportionate liability, Congress revised the Securities Exchange Act of 1934 and defined "a covered person" under the Act in two parts. 15 U.S.C. §78u-4(f)(10)(A)(i) and (ii). In part (i), Congress defined requirements for "an action that is based on an untrue statement of material fact or omission of a material fact." *Id.* In part (ii), Congress defined requirements for "an action that is based on any ***conduct*** that is not described in clause (i)." *Id.* Congress clarified that a "covered person" is one who "engages in that ***conduct*** with actual knowledge of the facts and circumstances that make the ***conduct*** of that covered person a violation of the securities laws." *Id.*

The statute must be read "so as to avoid rendering superfluous any parts thereof." *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991). Section (ii) demonstrates Congress' intent to continue to make unlawful not only misstatements and omissions covered by subsection (i) but also ***deceptive*** as well as manipulative ***conduct***. Had Congress wanted to limit "conduct" to manipulative trading practices as the Eighth Circuit did in this case, it could easily have said "manipulative" conduct—but did not. *See Central Bank*, 511 U.S. at 176-77 (If Congress wanted abettor liability, it would have used the words "aid" and "abet."). By broadly using the term "conduct" in the PSLRA, Congress retained deceptive acts as actionable conduct under §10(b).

II. *Central Bank* Rejected Aiding and Abetting Liability Under Section 10(b), Defining Such Conduct as It Had Been Cabined by Prior Circuit Cases to Knowingly Assisting Another's Misrepresentations Through Otherwise Lawful Conduct, Thus Limiting Its Holding to Those "Who Did Not Commit a Manipulative or Deceptive Act"

Aiding and abetting liability under §10(b)—as it existed prior to *Central Bank*—was conditioned on proof of three elements: "(1) the existence of a securities law violation

by the primary party (as opposed to the aiding and abetting party); (2) 'knowledge' of the violation on the part of the aider and abettor; and (3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation." *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985). Most circuits followed this standard. *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983); *Monsen v. Consol. Dressed Beef Co., Inc.*, 579 F.2d 793 (3d Cir. 1978); *Schatz v. Rosenberg*, 943 F.2d 485, 495 (4th Cir. 1991); *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 652 (9th Cir. 1988).

It was in the context of this understanding of aiding and abetting that this Court in *Central Bank* rejected abettor liability and held that §10(b) required more. Indeed, in reaching its decision, this Court acknowledged a similar concern to that expressed by the Seventh Circuit in diverging from the majority of circuits by requiring that the defendant "commit one of the 'manipulative or deceptive' acts prohibited under section 10(b) and rule 10b-5" to be liable for aiding and abetting. *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986); *accord Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1123 (7th Cir. 1990). Citing *Barker*, this Court explained that "the Seventh Circuit has held that the defendant must have committed a manipulative or deceptive act to be liable under §10(b), a requirement that in effect forecloses liability on those who do no more than aid or abet a 10b-5 violation." *Central Bank*, 511 U.S. at 170.

Whereas the Seventh Circuit did not hold that aiders and abettors could not be liable under §10(b), this Court could and did. But, like the Seventh Circuit, this Court's decision in *Central Bank* was based on the concept that "the defendant must have committed a manipulative or deceptive act to be liable under §10(b)" and that those who do not commit such conduct "do no more than aid or abet" another's violation and are not liable. *Central Bank*, 511 U.S. at 170. This Court

required actual commission of a proscribed act rather than mere "substantial assistance" and "knowledge" of another's primary violation. *Id.* at 190.

The critical distinction in *Central Bank* was between conduct—generally legitimate business conduct—that simply assists in the consummation of the transaction that harms the investor, and conduct that is itself at the heart of the fraud. Indeed, this distinction is crucial in separating aiding and abetting conduct from primary violator conduct. In *Central Bank*, this Court emphasized that plaintiffs did not allege that Central Bank of Denver committed "a manipulative or deceptive act," and indeed had conceded there were no such acts. *Id.* at 191. Instead, the plaintiffs alleged that the bank assisted Colorado Springs-Stetson Hills Public Authority's fraudulent promotion of bonds simply by knowingly delaying its appraisal of the property that was security for the loan. *Id.* at 168. In short, *Central Bank* refused to impose §10(b) liability on actors who merely aided and abetted another's fraud by lawful conduct that knowingly assisted in the transaction's consummation, as opposed to committing an unlawful deceptive act themselves. *Compare Peat Marwick*, 857 F.2d at 652 (financial statements certified by accounts were not misleading, but the accountant held to be an aider and abettor because its certification assisted issuer raising funds from investors by touting a technology that the accountants knew was not as represented by the issuer).

As Judge Kaplan explained in *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472 (S.D.N.Y. 2005), "an aider and abettor is nothing more nor less than someone who deliberately facilitates another's primary violation. *Central Bank* foreclosed liability for aiding and abetting the Rule 10b-5 violations of others, but the decision did not change the scope of Rule 10b-5 or what constitutes a primary violation of it." *Id.* at 493. Actively engaging in a sham transaction with the purpose and effect of causing a material misrepresentation is

a primary violation of §10(b) because the person has used or employed "a deceptive device or contrivance" proscribed by the statute.

CONCLUSION

For the foregoing reasons, the judgment of the Eighth Circuit should be reversed.

Respectfully submitted,

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